



llc operating agreements may need amending under california's new llc law

MSK Client Alert

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The New LLC Law

The California Revised Uniform Limited Liability Company Act (the "New LLC Law") was signed into law by Governor Jerry Brown on September 21, 2012. The New LLC Law will entirely replace the current California law governing limited liability companies ("LLCs"), the Beverly-Killea Limited Liability Company Act (the "Current LLC Law"), and will take effect on January 1, 2014.

In general, the New LLC Law has a more simplified structure compared with the Current LLC Law: in expressly upholding the principles of freedom of contract, the New LLC Law places a greater emphasis on the operating agreement being the binding document on the activities of an LLC and the rights and obligations of the members and/or managers, and provides a limited number of mandatory requirements. At the same time, the New LLC Law provides a comprehensive set of "default rules," which will apply if the members have not otherwise expressly agreed in their operating agreement. In addition, the New LLC Law provides new rules regarding certain issues such as the dissociation of a member and the fiduciary duties of members in a member-managed LLC and managers in a manager-managed LLC.

Applicability of the New LLC Law and Potential Risks for Existing LLCs

With respect to its applicability, unless otherwise specified, the New LLC Law will apply to LLCs established or registered on or after January 1, 2014, and will automatically apply to existing LLCs and to the actions and transactions taken by an existing LLC and its members and managers on or after January 1, 2014. The New LLC Law does not expressly extend its applicability to operating agreements executed before January 1, 2014; nevertheless, given the above-stated application requirement, any action taken after January 1, 2014, but based on a pre-2014 operating agreement will be scrutinized in light of the New LLC Law. For example, the validity of a vote or consent that is taken by the members and/or managers of an existing LLC after January 1, 2014, but is based on a

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voting provision in a pre-2014 operating agreement will be determined based on the New LLC Law. The application of the New LLC Law to pre-2014 operating agreements through an after January 1, 2014 action creates a possibility that the relevant part in the pre-2014 operating agreement (as in the case of the above voting provision example), or even the whole agreement, will be interpreted and assessed pursuant to the New LLC Law.

It should be noted that, given that the New LLC Law provides a number of default rules that are new or different from the counterpart rules in the Current LLC Law, an interpretation based on the New LLC Law may change the rights and obligations of the members and/or managers of an existing LLC in a way inconsistent with the members' and/or managers' original intentions. In order to avoid the risk of unintended consequences and potential disputes, members and/or managers of existing LLCs are advised to have their operating agreements reviewed by legal counsel in light of the New LLC Law and to make any necessary amendments to the operating agreement to preserve as much as possible the intent of the parties to the pre-2014 operating agreement. In particular, if the members and/or managers do not want the default rules of the New LLC Law to apply, they should include provisions in their operating agreement that clearly override those specific unwanted default rules.

As an example to illustrate how a new default rule may affect an existing operating agreement, the New LLC Law provides revised and new default rules concerning the allocation of management authority and voting rights among the members and/or managers in a manager-managed LLC, including:

The consent of all members of an LLC is required to do any of the following:

1. Sell, lease, exchange, or otherwise dispose of all, or substantially all, of the LLC's property, with or without the goodwill, outside of the ordinary course of the LLC's activities;
2. Approve a merger or conversion under the New LLC Law; or
3. Undertake any other act outside of the ordinary course of the LLC's activities.

These default rules can only be changed by a written operating agreement.

As the Current LLC Law does not contain similar default rules, existing operating agreements of manager-managed LLCs were often drafted to provide to the manager(s) general management power and limit this power by enumerating actions that would require members' approval, without specifically limiting any of the members' voting rights. In light of the New LLC Law, if members and managers of existing LLCs want the manager(s) to have greater authority over the above-listed matters than the default rules provide, they should evaluate whether the relevant provisions in their operating agreements are sufficient to achieve that purpose. In order to clearly override the above default rules, it may be necessary not only to provide the scope of the managers' management power, but also specifically to limit the scope of member's voting rights on the above-listed matters. Otherwise, disputes may arise over the validity of a managers' action on the above-listed matters if taken without the consent of all members.



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In addition to the new rule discussed above, the New LLC Law provides new or different default rules in primarily the following areas: (1) Fiduciary duties that managers owe to a manager-managed LLC and members owe to a member-managed LLC; (2) Indemnification and reimbursement of managers and members; (3) Transferable interests and rights of transferees; (4) Dissociation of a member; (5) Rights of a deceased or incapacitated member's legal representatives.

The above discussion does not provide a complete list of all the differences between the New LLC Law and the Current LLC Law; however, we hope it provides you with a basic awareness of the major differences that may be relevant to your operating agreement. Please contact us if you have any questions regarding the New LLC Law's impact on your LLC, and/or if you need your LLC's operating agreement to be reviewed for any possible necessary amendments.